

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-01 INR-10  
L-03 NSAE-00 NSC-05 PA-01 SP-02 SS-15 USIA-06  
AID-05 COME-00 EB-08 FRB-03 XMB-02 OPIC-03 LAB-04  
SIL-01 OMB-01 STR-07 CEA-01 /096 W  
-----104971 231705Z /40

P R 231500Z MAR 78  
FM AMEMBASSY ROME  
TO SECSTATE WASHDC PRIORITY 1526  
TREASURY DEPT WASHDC PRIORITY  
INFO AMEMBASSY BRUSSELS  
AMEMBASSY BONN  
AMEMBASSY LONDON  
AMEMBASSY PARIS

C O N F I D E N T I A L SECTION 1 OF 2 ROME 5404

BRUSSELS FOR USEEC; PARIS FOR USOECD

E.O. 11652: GDS  
TAGS: EFIN, IT  
SUBJECT: VIEWS OF MILAN'S BANKING COMMUNITY ON ECONOMIC SITUATION

1. SUMMARY. FOLLOWING ARE THE MAJOR POINTS OF INTEREST  
WHICH EMERGED DURING THREE-DAY VISIT (MARCH 15-17) BY TREASATT  
TO MILAN'S BANKING COMMUNITY: (1) LIRE EXCHANGE RATE IS  
EXPECTED TO REMAIN STABLE THROUGH THIS FALL (SEPTEMBER),  
AFTER WHICH IT MAY WEAKEN AS GROWTH TARGET OF 4.5 PERCENT  
BY YEAR-END IS APPROACHED; (2) DEPRECIATION OF DOLLAR  
IS INTERPRETED AS TEMPORARY PHENOMENON AND THAT ITS  
LONGER-TERM PROSPECTS ARE GOOD; (3) ITALIAN  
EXPORTS, IN TERMS OF MARKET SHARES, WILL PROBABLY NOT  
DO AS WELL IN 1978 AS IN 1977; (4) THE "ITALIAN RISK"  
HAS IMPROVED AND ITALY, IF IT WANTED, COULD PROBABLY  
FLOAT SUCCESSFULLY A SIZEABLE EURODOLLAR LOAN;  
(5) FOREIGN BORROWING BY ITALIAN COMMERCIAL BANKS IS  
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AGAIN ON THE RISE; (6) INVESTMENT DEMAND REMAINS DEPRESSED  
AND CONSUMERS HOLD THE KEY TO SHORT-TERM GROWTH PROSPECTS;  
(7) VARIOUS INDICATORS POINT TO A BOTTOMING OUT, IF  
NOT A PICKUP, OF ECONOMIC ACTIVITY; (8) SMALL AND MEDIUM-  
SIZED FIRMS REMAIN PROFITABLE, A FACTOR ATTRIBUTABLE TO  
A MORE FLEXIBLE SYSTEM OF LABOR RELATIONS THAN THAT  
FACED BY LARGE FIRMS WHICH CONTINUE TO SUFFER HEAVY

LOSSES, END SUMMARY.

2. THE EXCHANGE MARKET: THE CONSENSUS OF MILAN'S BANKING COMMUNITY IS THAT THE LIRE EXCHANGE RATE WILL REMAIN STABLE (WITH RESPECT TO THE DOLLAR) THROUGH THIS FALL. THE SEASONABLY ADVERSE PERIOD IS OVER AND ANOTHER GOOD TOURIST SEASON IS EXPECTED THIS YEAR. THE STRENGTH OF THE LIRE DURING THE PAST SIX MONTHS SURPASSED ALL EXPECTATIONS. ONE BANKER SAID THAN AN INTERNAL PROJECTION MADE LAST FALL HAD PREDICTED A LIRE/DOLLAR RATE OF ABOUT 920 DURING THE FIRST QUARTER OF 1978. THE STABILITY OF THE LIRA DURING THE PAST WINTER IS ATTRIBUTABLE TO THE DEPRECIATION OF THE DOLLAR AGAINST THE STRONGER CURRENCIES AS WELL AS TO THE BETTER-THAN-EXPECTED PERFORMANCE OF ITALY'S BALANCE OF PAYMENTS WHICH REMAINED IN SURPLUS THROUGHOUT THE SEASONALLY ADVERSE PERIOD. THE LIRA IS EXPECTED TO SHOW SOME WEAKENING BEGINNING SEPTEMBER/OCTOBER. THIS BECAUSE OF TWO FACTORS: (A) THE START OF THE SEASONALLY ADVERSE PERIOD, AND (B) INCREASED IMPORTS CONNECTED WITH THE EXPECTED ACCELERATION OF GROWTH DURING THE FOURTH QUARTER (THE GOVERNMENT IS FORECASTING A GROWTH OF 4.5 PERCENT BY YEAR-END). THAT THE LIRA WILL REMAIN STABLE THROUGH THE FALL IS ALSO REFLECTED IN THE ACTIVITY OF THE FORWARD MARKET. ITALIAN IMPORTERS ARE NOT COVERING FORWARD. ALSO, THERE IS INCREASED ACTIVITY ON THE FORWARD MARKET BY NON-RESIDENTS, CONFIDENTIAL

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ESPECIALLY BY LONDON-BASED AND ARAB BANKS. BECAUSE BANKS HAVE TO MAINTAIN A IVEN BALANCE BETWEEN THEIR FORWARD SALES AND PURCHASES OF LIRE, UNDER REGULATIONS SET BY THE UFFICIO ITALIANO DEI CAMBI (THE CURRENT BALANCE IS \$350 MILLION FOR THE ENTIRE BANKING SYSTEM), THIS INCREASED ACTIVITY IS NOT FULLY REFLECTED ON THE FORWARD RATE. UNDER THESE UIC RESTRICTIONS, THEREFORE, THERE ARE ALWAYS OFFSETTING FORCES ON THE FORWARD MARKET. ONE BANKER ESTIBMATED THAT THE DAILY VOLUME IN THE FORWARD LIRA MARKET IS CURRENTLY AROUND \$1.0 BILLION.

3. THE DOLLAR: MILANESE BANKERS, LIKE OFFICIALS AT THE BANK OF ITALY, ARE NOT OVERLY WORRIED ABOUT THE DEPRECIATION OF THE DOLLAR, EXCEPT TO THE EXTENT THAT IT MIGHT HAVE NEGATIVE REPERCUSSIONS ON THE WELL-BEING OF THE WORLD ECONOMY. THESE BANKERS ARE GENERALLY SUPPORTIVE OF OUR INTERVENTION POLICY AND ACHKNOWLEDGE THE INADVISABILITY OF TRYING TO PEG THE DOLLAR TO A SPECIFIC RATE. TWO BANKERS BELIEVED THE DOLLAR HAD BEEN OVERSOLD AND ONCE THE US HAD AN ENERGY POLICY IN PLACE IT WOULD BOUNCE BACK. MILANESE BANKERS ADMIT THAT THE DEPRECIATION OF THE DOLLAR HAS BEEN A BOON TO THE LIRA

IN RECENT MONTHS.

4. ITALIAN EXPORTS: ONE BANKER WHO HAD APPARENTLY STUDIED THE SUBJECT IN SOME DEPTH SAID THAT ITALIAN EXPORTS THIS YEAR ARE UNLIKELY TO GROW FASTER THAN WORLD TRADE, AS THEY DID DURING 1977. THE REASON FOR THIS IS THAT RECENT EXPERIENCE SHOWS THAT ITALIAN EXPORTS TEND TO RISE (AS A SHARE OF THE WORLD MARKET) WHEN THE DOMESTIC ECONOMY IS DEPRESSED AND STABILIZE (OR EVEN DECREASE) WHEN DOMESTIC ECONOMIC ACTIVITY IS ON THE UPSWING. WITH THE GROWTH RATE EXPECTED TO ACCELERATE DURING THE SECOND HALF, THE HISTORICALLY DEPRESSING EFFECTS ON EXPORTS SHOULD AGAIN BECOME OPERATIVE. THIS PHENOMENON IS EXPLAINED, ACCORDING TO THIS BANKER, BY THE FACT THAT ITALIAN INDUSTRY  
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IS UNABLE TO REDUCE COSTS DURING A SLOWDOWN, SUCH AS BY LAYING OFF WORKERS. CONSEQUENTLY, DURING A PERIOD OF STAGNATION, FIRMS ARE PREPARED TO SHAVE THEIR PROFIT MARGIN IN ORDER TO SELL OFF THEIR OUTPUT ABROAD, ALLOWING EXPORTS TO GROW FASTER THAN THEY MIGHT OTHERWISE. ASKED WHETHER THIS WAS "DUMPING," THE BANKER ACKNOWLEDGED THAT IT MIGHT BE.

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INFO AMEMBASSY BRUSSELS  
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C O N F I D E N T I A L SECTION 2 OF 2 ROME 5404

BRUSSELS FOR USEEC; PARIS FOR USOECD

5. ITALIAN RISK: ALL THE AMERICAN BANKERS CONTACTED INDICATED THAT THEIR INSTITUTIONS ARE GIVING A MORE FAVORABLE RECEPTION TO LOAN REQUESTS FROM ITALY THAN A YEAR AGO. CITED AS AN IMPORTANT FACTOR IN THIS CHANGE OF ATTITUDE IS THE EVIDENT SUCCESS OF THE ANDREOTTI STABILIZATION PROGRAM, AT LEAST INsofar AS THE BALANCE OF PAYMENTS IS CONCERNED. A RELATED FACTOR MENTIONED WAS THE ELIMINATION OF THE "SPECIAL MENTION" BY THE COMPTROLLER OF THE CURRENCY. NON-AMERICAN BANKS REPORTEDLY SHARE THIS MORE BULLISH ATTITUDE. AN OFFICIAL OF AN AMERICAN BANK, WHICH WAS RUMORED LAST DECEMBER TO BE HEADING A CONSORTIA TO PUT TOGETHER A \$500 MILLION LOAN TO ITALY, SAID THAT, WHEN THE REPORT WAS PUBLISHED, HE RECEIVED A NUMBER OF REQUESTS BY NON-AMERICAN BANKS ASKING TO TAKE A PARTICIPATION. THE SAME BANKER OPINED THAT SHOULD A WELL-KNOWN ITALIAN ENTITY, SUCH AS IMI, DECIDE TO RAISE \$500 MILLION ON THE EURODOLLAR MARKET TODAY, IT WOULD HAVE LITTLE  
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DIFFICULTY.

6. COMMERCIAL BANK BORROWING: THE NET FOREIGN ASSET POSITION OF COMMERCIAL BANKS, WHICH DROPPED \$755 MILLION DURING THE FIRST TWO MONTHS OF THE YEAR, HAS BEEN REPORTEDLY ON THE RISE IN MARCH. ONE BANKER THOUGHT THE DROP DURING THE FIRST TWO MONTHS MAY HAVE BEEN ATTRIBUTABLE TO A CHANGE IN EXCHANGE RATE EXPECTATIONS, SINCE THIS PERIOD COINCIDED WITH THE POLITICAL CRISIS. INTEREST RATE DIFFERENTIALS REMAINED VIRTUALLY UNCHANGED DURING JANUARY AND FEBRUARY. WITH THE FORMATION OF THE NEW GOVERNMENT, FIRMS HAD APPARENTLY RETURNED TO FOREIGN CURRENCY BORROWING.

7. INVESTMENT DEMAND: COMMERCIAL BANKS IN ITALY ARE LIMITED BY LAW TO SHORT-TERM LENDING (18 MONTHS). HOWEVER, BOTH AMERICAN AND ITALIAN COMMERCIAL BANKERS CONTACTED CORROBORATED THE VIEW EXPRESSED BY AN OFFICIAL OF A LARGE ITALIAN MEDIUM-TERM LENDING INSTITUTION THAT INVESTMENT DEMAND REMAINS DEPRESSED. THE ONLY INVESTMENT BEING UNDERTAKEN BY ITALIAN INDUSTRY IS TO REPLACE EXISTING PLANT AND EQUIPMENT. A NUMBER OF REASONS WERE CITED FOR THIS, MOST PROMINENTLY HIGH INTEREST RATES AND LOW CAPACITY UTILIZATION OF EXISTING PLANTS. ACCORDING TO THE OFFICIAL FROM THE MEDIUM-TERM CREDIT INSTITUTION, ENTREPRENEURS ARE REGAINING "COURAGE" AND SOME NEW INVEST-

MENTS MAY BE IN THE OFFING IN THE NEAR FUTURE. THEREFORE, CONSUMPTION, PARTICULARLY PRIVATE CONSUMPTION, HOLDS THE KEY TO FUTURE GROWTH PROSPECTS. ONE ITALIAN BANKER EXCLUDED THE POSSIBILITY THAT ACCUMULATION OF STOCKS WILL BE A SIGNIFICANT FACTOR IN ANY ECONOMIC UPTURN. ITALIAN FIRMS HAVE APPARENTLY ADOPTED A MORE CAUTIOUS POLICY TOWARD STOCK ACCUMULATION AFTER THE 1974-75  
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EXPERIENCE.

8. ECONOMIC INDICATORS AND LEVEL OF ACTIVITY: AN ECONOMIST FROM A MAJOR ITALIAN BANK CONFIRMED THAT THE LEVEL OF ECONOMIC ACTIVITY IS ON THE UPSWING. HE CITED THE BEHAVIOR OF THE SEASONALLY ADJUSTED INDUSTRIAL PRODUCTION INDEX FOR THE LAST TWO MONTHS AND THE RECENT ISCO SURVEY OF BUSINESS OPINIONS. MOST OTHER BANKERS SHARED THIS VIEW. THE GENERAL CONSENSUS OF MILANESE BANKERS IS THAT THE GROWTH OF GDP IN 1978 WILL BE IN THE 2.0-2.5 PERCENT RANGE.

9. PROFITABILITY OF INDUSTRY: THE PROFITABILITY OF ITALIAN INDUSTRY DESERVEDLY RECEIVES A LOT OF ATTENTION BY BANKERS. WHEN ASKED WHY SMALL AND MEDIUM-SIZED FIRMS ARE CONSISTENTLY MORE PROFITABLE THAN THE LARGER ONES, BANKERS USUALLY RESPOND BY NOTING TWO FACTORS: (A) THAT SMALLER FIRMS REACT FASTER TO CHANGING MARKET CONDITIONS, AND (B) LABOR RELATIONS AT THIS LEVEL ARE LESS POLITICIZED THAN THOSE WITH LARGER FIRMS. THE SMALLER FIRM, THEREFORE, HAS THE FLEXIBILITY TO DECREASE ITS LABOR FORCE WHEN THE ECONOMY IS DEPRESSED. MANAGEMENT AND LABOR HAVE APPARENTLY BEEN ABLE TO WORK OUT A MODUS VIVENDI AT THE SMALL-FIRM LEVEL OF THE TYPE WHICH HAS NOT YET BEEN POSSIBLE AT THE LARGER-SIZE FIRM LEVEL. BANKERS ARE NOT SURE THAT THIS SITUATION WILL CHANGE OVER THE SHORT-TERM, EVEN THOUGH LABOR LEADERS ARE SEEMINGLY TALKING ABOUT PURSUING A MORE FLEXIBLE LINE. LABOR COST, EVERYONE AGREES, IS A MAJOR HURDLE TO BE OVERCOME IF THE ECONOMY IS TO RESUME A SATISFACTORY, SUSTAINABLE, LEVEL OF GROWTH. GARDNER

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## Message Attributes

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